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BEFORE THE ARIZONA CORPORATION COMMISSION

Marc Spitzer
Chairman
Jim Irvin
Commissioner
William A. Mundell
Commissioner
Mike Gleason
Commissioner
Jeff Hatch-Miller
Commissioner

Arizona Corporation Commission
DOCKETED
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IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC DIVISION OF CITIZENS COMMUNICATIONS COMPANY TO CHANGE THE CURRENT PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE RATE, TO ESTABLISH A NEW PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE BANK, AND TO REQUEST APPROVED GUIDELINES FOR THE RECOVERY OF COSTS INCURRED IN CONNECTION WITH THE ENERGY RISK MANAGEMENT INITIATIVES.	DOCKET NO. E-01032C-00-0751
IN THE MATTER OF THE APPLICATION OF CITIZENS COMMUNICATIONS COMPANY, ARIZONA GAS DIVISION, FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO PROVIDE SUCH A RATE OF RETURN.	DOCKET NO. G-01032A-02-0598
IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS COMMUNICATIONS COMPANY AND UNISOURCE ENERGY CORPORATION FOR THE APPROVAL OF THE SALE OF CERTAIN ELECTRIC UTILITY AND GAS UTILITY ASSETS IN ARIZONA, THE TRANSFER OF CERTAIN CERTIFICATES OF CONVENIENCE AND NECESSITY FROM CITIZENS COMMUNICATIONS COMPANY TO UNISOURCE ENERGY CORPORATION, THE APPROVAL OF THE FINANCING FOR THE TRANSACTIONS AND OTHER RELATED MATTERS.	DOCKET NOS. E-01933A-02-0914 E-01932C-02-0914 E-01932A-02-0914

NOTICE OF FILING

Pursuant to the Procedural Order dated February 7, 2003, the Arizona Utility Investors Association (AUIA) hereby file the direct testimony of Walter W. Meek in the above-captioned matter.

Respectfully submitted this 21st day of April, 2003

Walter W. Meek

WALTER W. MEEK, PRESIDENT

CERTIFICATE OF SERVICE

Original and seventeen (17) copies of the references testimony were filed this 21st day of April, 2003, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Copies of the referenced testimony were hand-delivered this 21st day of April, 2003, to:

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Commissioner Jim Irvin
Commissioner William Mundell
Commissioner Mike Gleason
Commissioner Jeff Hatch-Miller
Paul Walker, Esq., Commissioner Wing
Kevin Barlay, Esq., Commissioner Wing
Hercules Dellas, Esq., Commissioner Wing
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Copies of the referenced Testimony
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Walter W. Meek

Walter W. Meek

DIRECT TESTIMONY

OF

WALTER W. MEEK

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Walter W. Meek. My business address is 2100 North Central Avenue, Suite 210, Phoenix, Arizona 85004.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am president of the Arizona Utility Investors Association ("AUIA" or "Association"), a non-profit organization formed to represent the interests of shareholders and bondholders who are invested in utility companies based in or doing business in the state of Arizona.

Q. ARE SOME AUIA MEMBERS SHAREHOLDERS OF THE JOINT APPLICANTS IN THIS PROCEEDING?

A. Yes. AUIA has approximately 6,500 individual members, including common shareholders of Citizens Communications Company ("Citizens," formerly Citizens Utilities), and UniSource Energy Corporation.

Q. WHAT IS YOUR BACKGROUND IN REPRESENTING SHAREHOLDER CONCERNS AND INTERESTS?

A. I have been president of AUIA for nine years. Prior to that, my consulting firm managed the affairs of the Pinnacle West Shareholders Association for 13 years. During these periods we have represented shareholders in numerous rate cases and other regulatory matters and have published many position papers, newsletters and other documents in support of shareholder interests.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am here to represent the views of the equity owners of Citizens Communications and UniSource Energy Corporation in the proposed sale of Citizens' Arizona gas and electric assets to UniSource.

Q. WAS AUIA AN INTERVENOR IN DOCKET NO. E-01032C-00-0751, REGARDING CITIZENS' UNDER-RECOVERED PURCHASED POWER COSTS?
A. Yes.

Q. DID YOU SUBMIT TESTIMONY IN THAT PROCEEDING?
A. We filed direct testimony and numerous other pleadings.

Q. SO, YOU ARE FAMILIAR WITH THE ISSUES IN THAT CASE?
A. Very familiar.

Q. DID AUIA INTERVENE IN THE GAS RATE CASE THAT IS A PART OF THE SETTLEMENT AGREEMENT?
A. No, but I am generally familiar with the elements of that case.

Q. HAS AUIA FORMED AN OPINION ABOUT THE SETTLEMENT AGREEMENT?
A. Yes. We support the agreement, but with some reluctance.

Q. WHAT IS THE CAUSE OF AUIA'S RELUCTANCE?
A. The fact that this transaction is being financed on the backs of the shareholders of Citizens Communications Company.

Q. IN WHAT RESPECT?
A. First, UniSource is paying less than 60 percent of book value for Citizens' gas and electric assets, a discount of $183 million. Second, Citizens' shareholders have been subsidizing electric service in Mohave and Santa Cruz counties for nearly three years and they will never recover any of that expense.

Q. ARE YOU REFERRING TO THE UNDER-RECOVERED PURCHASED POWER COSTS?
A. Yes.

Q. WHAT IS THE MAGNITUDE OF THE UNRECOVERED COSTS?

A. At the time testimony was filed in the fuel adjustment case, my estimate was about $100 million. The joint applicants now estimate that the purchased power and fuel adjustment clause (PPFAC) bank balance will reach $135 million by the end of July, when the applicants hope to receive Commission approval of this transaction.

Q. AND WHO HAS BEEN FUNDING THESE UNRECOVERED COSTS?

A. The shareholders of Citizens Communications Company.

Q. WHO WOULD PAY FOR THEM UNDER THE SETTLEMENT AGREEMENT?

A. The shareholders of Citizens Communications Company.

Q. DOES AUIA BELIEVE THIS TRANSACTION AND THE SETTLEMENT AGREEMENT ARE IN THE PUBLIC INTEREST?

A. Without question. This agreement produces between $140 million and $150 million of direct benefits to consumers. It is the best deal that Citizens' ratepayers could hope to get under the circumstances and it provides the means for Citizens to exit the gas and electric businesses in Arizona.

Q. WHAT WOULD HAPPEN IF THE TRANSACTION FAILED?

A. In the first place, Citizens would proceed to litigate its electric PPFAC case aggressively, including a court appeal, if necessary. It should be remembered that neither the Staff nor RUCO argued for a complete denial of the unrecovered amounts.

Q. WHAT WAS IN DISPUTE?

As a practical matter, only the incremental cost incurred under the previous APS contract, from about June 2000 through May 2001 was disputed. That amounts to about $70 million. The remedy recommended by Staff and RUCO was to require Citizens to litigate the contract terms at the Federal Energy Regulatory Commission (FERC).

Q. WHAT WOULD HAPPEN IF THE TERMS OF THE CONTRACT WERE UPHELD AT FERC OR BY A COURT?

A. The Commission would be obligated to allow Citizens to collect the disputed amount from ratepayers through the PPFAC.

Q. WHAT IS INCLUDED IN THE REST OF THE PPFAC BANK BALANCE?

A. The accumulated difference between the cost of power that Citizens is authorized to collect in rates and the amount it has had to pay since June 2001 when it renegotiated its wholesale contract with APS/Pinnacle West Energy Services.

Q. HOW MUCH IS THAT DIFFERENCE?

A. Including energy, transmission and line losses, the difference is a little more than 1.8 cents per kilowatt-hour (kWh). The cumulative difference as of July 28 would be about $60 million.

Q. WHAT ARE THE CHANCES THAT CITIZENS COULD RECOVER THAT MUCH FROM RATEPAYERS?

A. In my view, excellent. No one has shown that the existing contract was imprudent or that it is seriously out of market.

Q. APART FROM THE PPFAC, WHAT ELSE WOULD HAPPEN IF THE PURCHASE FELL THROUGH?

A. Citizens would pursue the full $21 million increase in the revenue requirement included in its gas rate case filing. That would be $5.8 million more than the figure arrived at in the settlement agreement. In addition, Citizens probably would not volunteer to write down its gas rate base by $10 million, as UniSource has agreed to do in the settlement.

Q. ARE THERE OTHER CONSEQUENCES OF A FAILED TRANSACTION?

A. Citizens' assets would continue to be for sale and the company would be a reluctant operator of utility systems it would like to unload. Who knows what kind of buyer would make the next offer or on what terms?

In this instance, we have a local company that is well known to this Commission, a respected member of the Arizona business community and a solid contributor to the social fabric of its service territory.

Q. WHY DOES CITIZENS WANT TO SELL THESE PROPERTIES?

A. Citizens' national business plan since 1999 has been to expand its telecommunications business and sell off its traditional utility systems, partly to raise capital to pay for the purchase of telephone access lines. The Arizona gas and electric divisions are the only utility properties that Citizens still owns. Citizens' Arizona employees are dedicated to providing quality service, but since Citizens has shrunk its utility operations, it is my impression that there is diminished corporate support for the Arizona business units. It is not a very positive environment.

Q. WHAT ARE UNISOURCE'S PLANS REGARDING THE PURCHASED POWER CONTRACT WITH PINNACLE WEST?

A. Although UniSource is giving up collections on Citizens' previous losses, the settlement agreement asks the Commission to approve the contract charges going forward. UniSource pledges to discuss renegotiating the contract with Pinnacle West and the agreement specifies that 60 percent of any resulting savings would go to ratepayers.

Q. HAS THERE BEEN CRITICISM OF THE CONTRACT?

A. There has been what I would call ad hoc criticism of the contract, based in part on the perceived weakness in today's wholesale market. However, nobody has made the case that the contract was imprudent when it was negotiated or that it is out of market today.

Q. WHAT IS AUIA'S VIEW?

A. This is a prudent contract. It was negotiated in May/June 2001, at a time when few long-term contracts were being negotiated except by the State of California, which shaped the market by purchasing thousands of megawatts of capacity and energy. California's performance is about the only available comparison to this contract. My understanding is that seven cents per kWh was at the low end of California's deals and most were much higher. We also have contemporary evidence in this docket, although it is under confidential seal, that the contract is not out of market.

Some other things should be kept in perspective: The distribution company makes nothing on the cost of generation; it is a straight pass-through. Also, this contract is not comparable to spot market pricing. It is a firm, long-term, full requirements contract with a fixed price. It also eliminates any possibility of stranded costs because it allows Citizens/UniSource to reduce its requirements without penalties.

Q. WHAT ARE THE EFFECTS OF THIS TRANSACTION ON TEP'S RATEPAYERS?

A. The basic structure of the deal, utilizing separate subsidiaries that will issue their own debt, holds the ratepayers harmless. There is even a ratepayer benefit of more than $5 million in the settlement agreement from the interest premium on the proposed TEP loan to UniSource. Eventually, there may be operating synergies that will contribute to lower TEP revenue requirements.

Q. WHAT IS THE IMPACT ON UNISOURCE'S SHAREHOLDERS?

With regard to the shareholders, it is hard to say at this point. In general, it is certainly beneficial for UniSource to grow its customer base in Arizona with minimal capital investment and at a bargain basement price.

UniSource shareholders are also held relatively harmless by the structure of the acquisition and the financing plan. While there are restrictions on dividend payouts related to equity ratios, they are not unreasonable.

Having said that, it would not be in anyone's interest for this transaction to founder due to anemic revenues.

Q. ARE YOU REFERRING TO THE GAS CASE REVENUES?

A. Yes. In my view, the ability to finance this acquisition and to sustain it depends on an adequate revenue stream from the gas operation. In the latest version of the settlement agreement, UniSource has reduced the revenue deficiency by nearly $1.5 million, compared with its original settlement proposal submitted in January.

Q. DOES THAT THREATEN THE VIABILITY OF THE TRANSACTION?

A. I believe that the revenue requirement has been squeezed to the danger point, especially when the settlement agreement prohibits a gas or electric rate case for three years. It is my understanding that the electric division has nearly doubled its plant in service since its last rate case and, therefore, is already overdue for a rate adjustment.

Q. ARE THE FUNDAMENTALS OF THE GAS RATE CASE APPROPRIATE?

A. They are marginally acceptable. We believe the Fair Value Rate Base (FVRB) of $142,132,013 is understated and that the cost of equity should approach 12.00 percent. Since we are not going to win those arguments, an overall rate of return of 7.49 percent on FVRB is not unreasonable.

Q. DOES AUIA HAVE ANY FURTHER CONCERNS ABOUT THE SETTLEMENT AGREEMENT?

A. Yes. We have an oblique concern about the disposition of the purchased gas adjustor (PGA). The settlement agreement states that the PGA shall not be affected by the agreement and that previous Commission orders shall prevail regarding the PGA bank balance. The PGA balance is currently scheduled to zero out in September, but we do not believe it will.

Q. WHAT EFFECT COULD THAT CREATE?

A. That raises the prospect of a continued PGA surcharge into the winter months at the same time that a rate increase is being implemented. As I stated earlier, we are concerned about adequate revenue streams and cash flow from the gas operation. Strictly speaking, the PGA mechanism does not affect operating income. However, the Commission has reacted nervously in the past to a wintertime PGA surcharge and we think the issue should be addressed before any ad hoc decision is made that affects cash flow negatively.

Q. DO YOU HAVE ANY CONCLUDING REMARKS?

A. Yes. Although AUIA is not supportive of the treatment of the shareholders of Citizens Communications Company, there is no question that the transaction represented by the settlement agreement is a good deal for Citizens' ratepayers. It contains nearly $150 million worth of direct consumer benefits.

The structure of the transaction and the proposed financing plan, coupled with certain restrictions in the settlement agreement, provide adequate buffering and risk mitigation to protect TEP and Citizens ratepayers.

There is also no question that UniSource Energy Corporation is a fit and proper entity to acquire Citizens' gas and electric assets.

For these reasons, the transaction is squarely in the public interest.

The public interest is also affected by the fact that Citizens wants to exit the gas and electric businesses. The Commission should allow them to do so. If this transaction fails, the gas and electric properties will continue to be for sale and it is unlikely that any better deal will come along. In fact, any probable alternative to this transaction -- whether it be Citizens' continued ownership or a new offer from another buyer -- is likely to present greater risk and higher liabilities for ratepayers than this transaction.

AUIA respectfully urges the Commission to approve the settlement agreement presented by the Staff and the joint applicants.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.